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Report No. DODIG-2013-006

October 19, 2012

# Inspector General

United States

Department *of* Defense



Defense Logistics Agency Could Improve Its Oversight of the Maintenance, Repair, and Operations Prime Vendor Contract for Korea

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## Acronyms and Abbreviations

|        |  |
|--------|--|
| C&E    | Construction and Equipment                       |
| CMP    | Contract Management Plan                         |
| DFAS   | Defense Finance and Accounting Service           |
| DLA    | Defense Logistics Agency                         |
| DLAD   | Defense Logistics Acquisition Directive          |
| FAR    | Federal Acquisition Regulation                   |
| MRO PV | Maintenance, Repair, and Operations Prime Vendor |
| NORAM  | North American Operations                        |





**INSPECTOR GENERAL**  
**DEPARTMENT OF DEFENSE**  
4800 MARK CENTER DRIVE  
ALEXANDRIA, VIRGINIA 22350-1500

October 19, 2012


**MEMORANDUM FOR UNDER SECRETARY OF DEFENSE FOR ACQUISITION,  
TECHNOLOGY AND LOGISTICS  
DIRECTOR, DEFENSE LOGISTICS AGENCY**

**SUBJECT: Defense Logistics Agency Could Improve Its Oversight of the Maintenance,  
Repair, and Operations Prime Vendor Contract for Korea  
(Report No. DODIG-2013-006)**

We are providing this report for your information and use. We performed the audit at the request of the Chairman, U.S. House of Representatives Subcommittee on National Security and Foreign Affairs, Committee on Oversight and Government Reform. The prime vendor obtained volume discounts on items purchased and credited those discounts to DoD. Also, the prime vendor did not seek rebates related to the prime vendor contract purchases and returned rebates it received in error. However, Defense Logistics Agency personnel allowed the prime vendor to charge questioned costs of approximately \$200,000 on purchases made between May 10, 2010, and August 1, 2011, because they did not have adequate review procedures in place. The total amount of questioned costs may be greater if all the delivery orders that occurred on the 7-year contract were reviewed.

We considered management comments on a draft of this report when preparing the final report. Comments from the Director, Defense Logistics Agency Troop Support conformed with the DoD Directive 7650.3; therefore, additional comments are not required. The proposed actions met the intent of the recommendations.

We appreciate the courtesies extended to the staff. Please direct questions to me at (703) 604-8866 (DSN 664-8866).

  
Alice F. Carey  
Assistant Inspector General  
Readiness, Operations, and Support

cc:  
Director, Acquisition Resources and Analysis



## Results in Brief: Defense Logistics Agency Could Improve Its Oversight of the Maintenance, Repair, and Operations Prime Vendor Contract for Korea

### What We Did

We performed the audit at the request of the Chairman, U.S. House of Representatives Subcommittee on National Security and Foreign Affairs, Committee on Oversight and Government Reform. Our objective was to determine whether the Maintenance, Repair, and Operations prime vendor contractor for South Korea, Universal Services (now Sodexo Remote Sites) received volume discount savings or rebates for items associated with contract SPM500-05-D-BP07, and if so, determine whether the prime vendor credited these savings and rebates to DoD.

### What We Found

The prime vendor obtained volume discounts through price competition on items purchased for DoD and credited those discounts to DoD. Additionally, the prime vendor did not seek rebates related to the Maintenance, Repair, and Operations prime vendor contract purchases and returned those rebates it received in error. However, Defense Logistics Agency (DLA) Troop Support, Construction and Equipment Directorate contract management personnel did not consistently monitor airfreight charges and fixed markup fees the prime vendor charged to DoD for purchases made under the Maintenance, Repair, and Operations prime vendor contract.

Specifically, DLA Troop Support Construction and Equipment contract management personnel did not:

- review and approve delivery orders with airfreight charges, or
- verify that delivery orders with fixed fee markup pricing complied with the maximum contractually established markup rate.

This occurred because DLA Troop Support Construction and Equipment contract management personnel did not have adequate purchase review and approval procedures in place. As a result, the prime vendor charged questionable costs of \$200,224 for purchases the prime vendor made between May 10, 2010, and August 1, 2011. The total amount of questioned costs may be greater if all the delivery orders that occurred on the 7-year contract were reviewed.

### What We Recommend

Among other recommendations, we recommended that the Director, DLA Troop Support, establish procedures to identify, analyze, and determine the allowability of delivery orders that include airfreight and fixed markup fees.

### Management Comments and Our Response

The Director, DLA Troop Support, agreed with our recommendations. We considered their comments to be responsive. Please see the recommendations table on page ii.

## Recommendations Table

| Management  | Recommendations<br>Requiring Comment | No Additional Comments<br>Required |
|---|--------------------------------------|------------------------------------|
| Director, Defense Logistics<br>Agency Troop Support |                                      | 1, 2, and 3                        |

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## Introduction

### Objective

Our objective was to determine whether the Maintenance, Repair, and Operations prime vendor (MRO PV) contractor for South Korea, Universal Services (now Sodexo Remote Sites) received volume discount savings or rebates for items associated with contract SPM500-05-D-BP07, and if so, determine whether the prime vendor credited these savings and rebates to the DoD. See Appendix A for a discussion of the audit scope and methodology.

### Background

We performed the audit at the request of the Chairman, U.S. House of Representatives Subcommittee on National Security and Foreign Affairs, Committee on Oversight and Government Reform. The Chairman received allegations that Sodexo, a major contractor for DoD, was receiving volume discounts and rebates from its suppliers on contract SPM500-05-D-BP07, but was not crediting these savings to DoD.

### *Prime Vendor Program*

DoD Reform Initiative Directive No. 45, "Prime Vendor Contracting Program for Facility Maintenance Supplies," August 24, 1998, states that the Defense Logistics Agency (DLA) changed its business practices and entered into long-term prime vendor sustainment contracts with various suppliers to provide materials needed to support the maintenance, repair, and operations for DoD facilities.

The DoD prime vendor program provides items quickly and meets the customer needs at discounted commercial prices, which helps reduce DoD's overall maintenance supply costs. Under the prime vendor concept, a single commercial distributor serves as the major provider of products or services to various Federal customers within a geographical region at discounted commercial prices. The MRO PV contracts are primarily long-term fixed price contracts with economic price adjustment or indefinite-delivery/indefinite-quantity delivery orders and generally, including options, span 5 years.

### *MRO PV Contract SPM500-05-D-BP07 and Modifications*

Defense Supply Center Philadelphia<sup>1</sup> personnel awarded contract SPM500-05-D-BP07, on March 31, 2005, to Sodexo Remote Sites. As part of the contract, the prime vendor, Sodexo Remote Sites provided maintenance, repair, and operations supplies to U.S. military bases in South Korea. DLA Troop Support Construction and Equipment (C&E) Directorate contract management personnel managed and administered the contract, valued at \$240 million. The

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<sup>1</sup> In 2010, Defense Supply Center Philadelphia was renamed DLA Troop Support. DLA Troop Support is an installation field site within DLA.

contract was set to expire in March 2012, but DLA extended it to March 2013. See Appendix C for contract generations, values, and time frames.

Also, modification 6 to the MRO PV contract, May 16, 2006, concerning prime vendor (contractor) purchasing reviews, states the following (as required by Defense Logistics Acquisition Directive [DLAD] clause 52.217-9017).

- Contractor purchases of any supplies or services to be provided under this contract with an extended line item value exceeding \$2,500 shall require a competitive quotation from at least two firms.
- If two or more suppliers or subcontractors are not available, the contractor shall retain supporting documentation (to include price quotations and invoices) for its selection of the supplier and for its determination that the price was fair and reasonable.
- A price is fair and reasonable if, in its nature and amount, it does not exceed that which would be incurred by a prudent person in the conduct of competitive business.
- The burden of proof shall be upon the contractor to establish that the price is reasonable under the standards in Federal Acquisition Regulation (FAR) subpart 15.4.
- When the contractor is purchasing from suppliers and receives a volume purchase discount or other rebate from the purchase action, the prime vendor will immediately credit these savings to the Government.
- The contractor is required to use diligence in the selection of the most economical method of delivery of the product or services by selecting a best value method of delivery based on the urgency and nature of the work or product required.
- The contractor will allow DLA Troop Support C&E, Defense Contract Management Agency, Defense Contract Audit Agency, or duly authorized Government representatives access to all records and information pertaining to pricing elements for the supplies or services provided to ensure that the prime vendor complies with contract requirements.

~~(FOUO)~~ Additionally, modification 16 to the MRO PV contract, May 10, 2010, established a matrix that shows the maximum markup fee based upon the dollar value of the order. The modification set a maximum “not to exceed” markup rate of <sup>(b) (4)</sup> percent.

## **MRO PV Related Criteria**

We used the standards, procedures, and metrics in the following guidance to assess the volume discount and rebate billing practices of the MRO PV for U.S. installations in South Korea.

### ***FAR Purchasing Procedures***

FAR subpart 15.403-1, “Prohibition on Obtaining Certified Cost or Pricing Data (10 United States Code 2306a and 41 United States Code 254b),” March 23, 2005, states that a price is based on adequate price competition if:

- two or more responsible offerors, competing independently, submit priced offers that satisfy the Government’s expressed requirement and if;



- the award will be made to the offeror whose proposal represents the best value where price is a substantial factor in source selection; and
- there is no finding that the price of the otherwise successful offeror is unreasonable. Any finding that the price is unreasonable must be supported by a statement of the facts and approved at a level above the contracting officer.

Also, FAR subpart 15.404-1, "Proposal Analysis Techniques," March 23, 2005, states that the contracting officer is responsible for evaluating the reasonableness of the offered prices. Normally, adequate price competition establishes price reasonableness.

Further, FAR subpart 15.406-3, "Documenting the Negotiation," September 30, 1997, states that the contracting officer will include documentation of fair and reasonable pricing.

### ***DLAD and Prime Vendor Arrangements***

DLAD Revision 5, May 11, 2000, implements and supplements the FAR and establishes DLA procedures relating to the acquisition of supplies and services. The DLAD is applicable to the contracting function at all DLA activities.

Specifically, DLAD subpart 17.9500, "Tailored Logistics Support Contracting," revised September 13, 2011, prescribes policies and procedures for placing orders and post-award administration under the DLA's tailored logistics support contracting initiatives, to include prime vendor arrangements. This subpart discusses the management attention required throughout the life of a tailored logistics support contract. The DLAD requires the tailored logistics support program manager to:

- develop a contract management plan (CMP) that describes how the prime vendor's performance will be monitored;
- include the clause on tailored logistics support purchasing reviews in all solicitations and contracts when the Government is relying on the contractor's purchasing system to verify that the contractor competed the items or services or to justify fair and reasonable pricing;
- seek refunds, rebates, and volume discounts from contracts in accordance with the clause requirements; and
- conduct periodic reviews/audits on the contractor.

Further, modification 6 of the MRO PV contracts contains the DLAD clause 52.217-9017 on tailored logistics support purchasing reviews, which requires that the prime vendor remit to the Government any savings from volume discounts or rebates received on behalf of Government purchases.

### **MRO PV CMP**

DLA Troop Support C&E contract management personnel administered the MRO PV contract under a CMP established by DLA for worldwide use for all MRO PV contracts (except for the contract for MRO support to the U.S. Central Command). The CMP assigns roles and responsibilities and sets forth procedures for management and administration of the MRO PV

contracts. Procedures and guidance in the CMP include pricing reviews and performance measures. Pricing reviews include fair and reasonable price determination, contract pricing compliance reviews, and price component analysis.

## **MRO PV Contract Key Players**

The following activities have key roles in managing, executing, and implementing the MRO PV contract. DLA Troop Support C&E contract management personnel manage and administer the MRO PV contract. Sodexo, as the MRO PV, executes the contract. Sodexo, Inc. (USA), Sodexo Group's North American Operations (NORAM), is headquartered in Gaithersburg, Maryland, and is a leading quality of daily life solutions company for the United States, Canada, and Mexico, with 700 facilities management sites and \$8.0 billion in annual revenue. NORAM has national supply contracts and rebate agreements with numerous companies. As part of its rebate program, NORAM collects incentive payments from participant suppliers and distributes those payments to Sodexo divisions based on purchases made under terms of national supply contracts. Sodexo Remote Sites (previously Universal Services), is a division of Sodexo Group with its principal business being food service (providing food services for oil rigs, college campuses, casinos, and military installations) and includes divisions located in:

- Tacoma, Washington – MRO PV for contract SPM500-05-D-BP07, which provides total logistic support of maintenance, repair and operations supplies to military installations and federal activities in South Korea;
- Seattle, Washington – staging and shipping point for prime vendor supplies headed to South Korea;
- South Korea – prime vendor inventory control point and warehouse; and
- Harahan, Louisiana – accounting function for the prime vendor.

Defense Finance and Accounting Service (DFAS) is a DoD Component established to provide finance and accounting services for DoD and other Federal activities. DFAS operates under the authority, direction, and control of the DoD Comptroller. DFAS makes payments to the prime vendor for work performed in accordance with the terms of contract SPM500-05-D-BP07.

## **Review of Internal Controls**

~~(FOUO)~~ DoD Instruction 5010.40, "Managers' Internal Control Program (MICP) Procedures," July 29, 2010, requires DoD organizations to implement a comprehensive system of internal controls that provides reasonable assurance that programs are operating as intended and to evaluate the effectiveness of the controls. We identified internal control weaknesses in the DLA Troop Support management and administration of the MRO PV contract for Korea. Specifically, DLA Troop Support C&E contract management personnel did not have adequate procedures in place to review and approve delivery orders with airfreight charges and to ensure that the prime vendor did not exceed the maximum contractually established markup rate of <sup>(b) (4)</sup> percent. We will provide a copy of the report to the senior official responsible for internal controls in the DLA and in the Office of the Under Secretary of Defense for Acquisition, Technology, and Logistics.



## Finding. DLA Troop Support C&E's Purchase Review Process Needs Improvement

The prime vendor obtained volume discounts through price competition on items purchased for DoD and credited those discounts to DoD. Additionally, the prime vendor did not seek rebates related to the MRO PV contract purchases and returned those rebates it received in error. However, DLA Troop Support C&E contract management personnel did not consistently monitor airfreight charges and fixed markup fees the prime vendor charged to DoD for purchases under the MRO PV contract. Specifically, DLA Troop Support C&E contract management personnel did not:

- review and approve delivery orders with airfreight charges, or
- ~~(FOUO)~~ verify that delivery orders with fixed fee markup pricing complied with the maximum contractually established markup rate of ~~(b) (4)~~ percent.

This occurred because DLA Troop Support C&E contract management personnel did not have adequate purchase review and approval procedures in place. As a result, the prime vendor charged questionable costs of \$200,224 for purchases the prime vendor made between May 10, 2010, and August 1, 2011. The total amount of questioned costs may be greater if all the delivery orders that occurred on the 7-year contract were reviewed.

### Volume Discounts Obtained Through Price Competition

The prime vendor obtained volume discounts through price competition on items purchased for DoD and credited those discounts to DoD. Specifically, the prime vendor generally complied with the FAR and contract requirements concerning adequate price competition.

FAR Subpart 15.403-1 generally states that price competition is adequate when two or more offers are submitted and the best value offeror is awarded. DLA Troop Support C&E contract management personnel and the prime vendor management officials each stated that if a volume discount was offered it was included in the price and credited to DoD in the form of an up-front price reduction. In addition, the five prime vendor suppliers interviewed stated that volume discounts were a factor included in their best price determination when submitting quotes to the prime vendor.

To test these assertions, we reviewed the contracting files for 72 nonstatistically selected delivery orders,<sup>2</sup> valued at \$5.2 million, executed between FY 2009 and FY 2011. During that same time period, the prime vendor issued a total of 48,925 delivery orders, valued at \$68.5 million, against the MRO PV contract. We sorted the prime vendor usage data listings by frequency of purchases, dollar amount, and quantity; and selected delivery orders from each category. DLA Troop Support C&E contracting officers followed established procedures and, with available information, generally determined that the prices were fair and reasonable for supply items procured for the selected delivery orders. Additionally, we independently obtained supporting documentation from the prime vendor, suppliers, and DFAS for the delivery orders. We reviewed the supporting documentation to include the original price quotes, supplier invoices,

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<sup>2</sup> The term "delivery order" generally denotes a line item in the prime vendor usage data listing.



prime vendor payments to the suppliers, and prime vendor charges to DoD for these transactions. The results were as follows.

- 66 of the 72 delivery orders reviewed were supported by at least two vendor quotes as required by the CMP and the FAR; for 65 of the 66 delivery orders, the award was made to the offeror whose proposal had the lowest price;
- 2 of the 72 delivery orders had sole source justifications; and
- 4 delivery orders had incomplete or missing documentation.

We concluded that the prime vendor's price quote process achieved both competition and lower prices by incorporating all discounts, including volume discounts, in up-front price quotes. Our results were consistent with pricing reviews on the MRO PV contract DLA and the Defense Contract Audit Agency conducted from FY 2009 through FY 2011 that concluded the prime vendor generally complied with contract requirements.

### **Prime Vendor Generally Complied With Rebate Requirements**

~~(FOUO)~~ The prime vendor did not seek rebates related to the MRO PV contract purchases and returned rebates it received in error. Modification 6 of the MRO PV contract states that when the prime vendor is purchasing from suppliers and receives a volume purchase discount or other rebate from the purchase action, the prime vendor will immediately credit these savings to the Government. The prime vendor's internal policy was not to take rebates based on MRO PV contract purchases, although one supplier identified \$9,518 in rebates it provided to Sodexo in FY 2006 based on purchases Sodexo made under the MRO PV contract. Both the supplier and prime vendor stated these rebates were caused by the supplier's accounting error. However, control deficiencies with the prime vendor's accounting system impeded efforts to identify whether the prime vendor received other rebates attributable to MRO PV purchases. Specifically,

- the prime vendor was not able to locate detailed accounting records dated before FY 2008 and was not able to properly trace rebates since that time;
- the prime vendor's Chief Financial Officer stated that before 2008, the prime vendor used three separate accounting systems to maintain records; and
- the prime vendor experienced a high turnover of Chief Financial Officers – five in a 5-year period.

~~(FOUO)~~ Additionally, before FY 2007, NORAM, another business unit of the prime vendor's parent company, did not provide detailed supporting information on rebates it passed on to the prime vendor. Further, the previously mentioned \$9,518 in rebates was never credited to DoD and went undetected for 6 years. NORAM and the prime vendor reimbursed \$9,518 to the supplier in April 2012.

We found no additional instances of rebates received and the prime vendor and NORAM stated that they plan to improve the internal management controls over receiving and accounting for supplier rebates. Therefore, we made no recommendations for DLA Troop Support C&E contract management personnel to take actions to ensure that the prime vendor's accounting system provides for a sound control environment related to rebates.



## DLA Troop Support C&E Personnel Did Not Consistently Monitor Airfreight and Fixed Markup Fees

~~(FOUO)~~ While the prime vendor used price competition to obtain volume discounts, DLA Troop Support C&E contract management personnel did not consistently monitor airfreight and fixed markup fees charged to the MRO PV contract. From May 10, 2010, through August 1, 2011, the prime vendor issued 19,017 delivery orders, valued at \$23.1 million, on the MRO PV contract. Because the delivery orders did not always delineate allowable airfreight charges, we compared the product purchase price to the total price charged DoD and identified 6,300 delivery orders (33 percent), valued at \$4.07 million, where the markup rate exceeded the maximum “not to exceed” markup rate of ~~(b) (4)~~ percent. These delivery orders appeared to include questioned charges or fees of \$200,224. We concentrated our review on 197 delivery orders, valued at \$1.26 million, where the difference between the product purchase price and the amount charged to DoD exceeded the ~~(b) (4)~~ percent threshold by at least \$100.<sup>3</sup> The apparent overcharges on the 197 delivery orders, totaling \$151,821, or \$771 on average, resulted from two risk areas – airfreight charges and fixed fee markup price variations (see the following table). See Appendix C for the scope of the review of questioned costs.

**Table. Reason for Markup Rate Exceeding Contract Maximum**

| Reason for Overcharges    | Delivery Orders | Total Order Value | Percentage of Total | Potential Overcharges | Percentage of Total |
|---------------------------|-----------------|-------------------|---------------------|-----------------------|---------------------|
| Air Freight <sup>1</sup>  | 96              | \$436,111         | 34.61               | \$117,004             | 77.07               |
| Fixed Fee                 | 97              | 810,696           | 64.34               | 34,155                | 22.50               |
| Undetermined <sup>2</sup> | 4               | 13,235            | 1.05                | 662                   | 0.44                |
| Totals                    | 197             | \$1,260,042       | 100.00              | \$151,821             | 100.00              |

Note: Figures in the Percentage of Total column do not sum due to rounding.

<sup>1</sup>Fixed fees also contributed to the effective markup rate in 14 of 96 airfreight orders.

<sup>2</sup>DLA did not provide sufficient documentation for these orders to determine the reason the markup rate exceeded the contract maximum.

Source: DoD Office of Inspector General.

## DLA Troop Support C&E Personnel Did Not Review and Approve Delivery Orders With Airfreight Charges

For the MRO PV contract, the prime vendor shipped most items by sea through the Defense Transportation System Commercial Carrier. However, the prime vendor also used airfreight to deliver items to South Korea. The prime vendor included airfreight in its costs and billed DoD with the applicable markup rate. The most frequent items airfreighted to South Korea included fiber optic cable assemblies, circuit breakers, lamps, motors, and valve assemblies. Shipping items from the United States to South Korea by airfreight normally shortened delivery time by a minimum of 2 weeks, but was more expensive than shipping by sea and was generally reserved

<sup>3</sup> The \$100 threshold was based on auditor judgment.



for "emergency" orders.<sup>4</sup> The prime vendor placed emergency orders for DoD ordering activities using estimated airfreight charges. The MRO PV contract pricing terms requires DLA Troop Support C&E contract management personnel to review the invoices to verify the accuracy of the delivery price and request refunds when overpricing occurred. However, DLA Troop Support C&E contract management personnel did not review and approve delivery orders with airfreight charges.

~~(FOUO)~~ We identified \$117,004 in questioned costs related to airfreight for the 14-month period. The total amount of questioned costs may be greater if all the delivery orders that occurred on the 7-year contract were reviewed. The amount of questioned costs related to airfreight charges varied. For example, the ordering activity at Osan Air Base requested that the prime vendor ship an emergency order by airfreight for 90, 55-gallon drums of liquid runway deicer. The prime vendor paid its supplier \$(b) (4) for the aircraft deicer and paid actual airfreight charges of \$(b) (4). The prime vendor ultimately charged \$(b) (4) to DoD for this transaction, which included \$(b) (4) for the deicer, an estimated \$(b) (4) in airfreight charges,

~~(FOUO)~~ *The prime vendor was required to return the \$5,260 difference between the estimated airfreight and the actual airfreight charged to DoD, but DLA Troop Support C&E contract management personnel did not request that the overcharge be returned.*

and the prime vendor markup fee of \$(b) (4). In accordance with the pricing terms of the contract, the prime vendor was required to return the \$5,260 difference between the estimated airfreight and the actual airfreight charged to DoD, but DLA Troop Support C&E contract management personnel did not request that the overcharge be returned. Additionally, the contracting officer's delivery order review notes did not state whether the emergency order was justified and made no mention of airfreight. In another

example, the ordering activity at Camp Humphreys requested that the prime vendor ship an emergency order by airfreight for 90, 50-pound bags of pool filter sand. The prime vendor paid its supplier \$(b) (4), plus airfreight of \$(b) (4), yet billed \$(b) (4) to DoD, which included the cost of the pool filter sand, an estimated airfreight of \$(b) (4), and prime vendor markup fee of \$(b) (4). Again, MRO PV contract terms require the prime vendor to return the \$77 difference in the estimated airfreight and the actual airfreight to DoD, but DLA Troop Support C&E contract management personnel did not request that the overcharge be returned. The contracting officer did not review this delivery order, so there was no review of emergency justification for airfreight.

### ***DLA Troop Support C&E Personnel Did Not Verify Compliance of Delivery Orders With Fixed Fee Markup Pricing***

~~(FOUO)~~ DLA Troop Support C&E contract management personnel did not verify that delivery orders with fixed fee markup pricing complied with the maximum contractually established markup rate. The markup fee (referred to as the distribution price in the MRO PV contract) is a fixed dollar amount, typically consisting of the prime vendor's projected general and

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<sup>4</sup> The MRO PV contract originally defined an "emergency order" as an order that had to be received within 7 days of order placement. Modification 17 to the MRO PV contract, May 6, 2010, removed the 7-day requirement for emergency orders. The modification stated that an order is an emergency order if shipping by sea would not meet the delivery date established by the prime vendor and the DoD ordering activity.



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(FOUO) administrative expenses, overhead, packaging costs, and anticipated profit. From inception of the MRO PV contract in March 2005 until May 10, 2010, there was no formal markup fee percentage (markup rate). DLA Troop Support C&E contract management

*The prime vendor continued to charge more than the maximum "not to exceed" markup rate for 33 percent of all delivery orders.*

personnel and the prime vendor agreed to and established modification 16 on May 10, 2010, in response to a recommendation made by the DoD Office of Inspector General,<sup>5</sup> to establish a maximum "not to exceed" markup rate of (b)(4) percent. However, we identified \$34,155 in questioned charges related to fixed fee markup pricing since the effective date of the modification. From May 10, 2010, through August 1, 2011, the prime vendor continued to charge more than the maximum "not to exceed" markup rate for 33 percent of all delivery orders.

(FOUO) The prime vendor Chief Financial Officer and DLA Troop Support C&E contract management personnel stated that the charges might have appeared excessive on some delivery orders reviewed because of variations caused by the fixed fee markup price. According to the prime vendor financial officer, the pricing terms of the contract provide for the prime vendor to establish a fixed dollar markup based on the initial order that remains fixed for the current contract year, which could result in an effective markup rate that exceeded the (b)(4) percent maximum.

When the markup dollar amount is fixed but supplier price varies, it could lead to an effective markup rate above the contract's maximum markup rate, as illustrated below.

- (FOUO) On March 24, 2009, the prime vendor and DLA established a fixed prime vendor markup dollar amount of \$(b)(4) per unit for a 265-gallon tote of runway deicer based on a (b)(4) percent markup fee on the unit price of \$(b)(4).
- (FOUO) On June 9, 2010, the prime vendor purchased an additional 15 units of the product for \$(b)(4) (\$(b)(4) per unit). The price dropped but the markup dollar amount remained the same at \$(b)(4) per unit.
- (FOUO) This led to an effective markup rate of (b)(4) percent (\$(b)(4)). Based on this fixed markup fee, the prime vendor billed a total of \$(b)(4) for 15 units (\$(b)(4) per unit) to DoD.

(FOUO) The prime vendor placed the order for the 265-gallon tote of runway deicer about 1 month after modification 16 went into effect. The effective markup rate on the order exceeded the maximum contracted "not to exceed" rate of (b)(4) percent. The contracting officer noted during the order review that the markup rate ((b)(4) percent) did not exceed the contract maximum. In another example, on June 9, 2010, the prime vendor filled an order for 13 street sweeper brushes for \$(b)(4). The prime vendor fees totaled \$(b)(4). The prime vendor noted

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<sup>5</sup> DoDIG Report No. D-2011-077, "Improved Management Can Reduce Costs of the Maintenance, Repair, and Operations Prime Vendor Contract for the Republic of Korea," June 24, 2011, and its associated "Memorandum for Commander Defense Supply Center Philadelphia," March 26, 2010, stated that the prime vendor exceeded the maximum informal markup rate ((b)(4) percent) for over 30 percent of the delivery orders issued during FYs 2008 and 2009.



(FOUO) that the fee was based upon a previous order that was later cancelled. The contracting officer review notes stated, "fee (b) (4) percent) does not exceed the contract maximum."

(FOUO) Additionally, the prime vendor Chief Financial Officer stated that the standard operating procedure when the markup rate exceeded 40 percent was to charge 40 percent to

*(FOUO) The prime vendor Chief Financial Officer stated that the standard operating procedure when the markup rate exceeded 40 percent was to charge 40 percent to DoD.*

DoD. This standard operating procedure should have ceased after the (b) (4) percent maximum was established; however, the prime vendor continued this practice. For example, in September 2010, the prime vendor issued an order for 29 sections of metal guardrails at a purchase price of \$(b) (4) per unit. The

prime vendor reached back 2 ½ years, to a previous order of the guardrails, to get the fixed markup fee of \$(b) (4) per unit. Charging a fixed fee markup of \$(b) (4) per unit would have increased the markup rate to (b) (4) percent, so the prime vendor reduced its markup to \$(b) (4) per unit or (b) (4) percent of the purchase price. Reaching back to cancelled orders or different option years was not a part of the contract provisions and should not have occurred.

## **DLA Troop Support C&E Personnel Did Not Have Adequate Purchase Review and Approval Procedures in Place**

DLA Troop Support C&E contract management personnel placed emphasis on their purchase review process to ensure the prime vendor achieved adequate price competition. However, they did not have adequate purchase procedures in place to review and approve delivery orders with airfreight charges and ensure that delivery orders with fixed fee markup pricing complied with the maximum contractually established markup rate.

MRO PV contract pricing terms state that DLA Troop Support C&E contract management personnel will:

- perform price verification analysis periodically throughout the contract term,
- review the invoice to verify the accuracy of the delivered price, and
- confirm that the markup does not exceed the contractually agreed maximum rate.

In addition, the MRO PV CMP tasks DLA Troop Support C&E contract management personnel to perform price component analysis on a semiannual basis and review prime vendor usage data to:

- identify initial markup fees (distribution fees) that exceed contract limitations,
- identify increases in fixed distribution fees, and
- pursue refunds if overpricing is uncovered.

However, DLA Troop Support C&E contract management personnel did not adequately review and approve delivery orders with airfreight charges. DLA Troop Support C&E contract management officials stated that estimated versus actual airfreight charges are to be periodically reconciled, but this was not always performed due to staff reductions. In addition, many delivery orders having airfreight charges were auto-approved, without contracting officer intervention,



and subject to fast payment procedures.<sup>6</sup> For example, 160 out of the 197 delivery orders reviewed were auto-awarded without contracting officer review or approval. This included auto-approval of the previously mentioned sand pool filter delivery order, where DLA Troop Support C&E contract management personnel did not review and reconcile the difference between the estimated and actual airfreight charges. DLA Troop Support C&E contract management personnel need to establish procedures to identify, analyze, and determine the allowability of delivery orders that include airfreight charges. DLA Troop Support C&E contract management personnel should also conduct a complete review of the purchases from the contract's inception in March 2005, which could result in additional questioned airfreight costs.

~~(FOUO)~~ Additionally, DLA Troop Support C&E contract management personnel did not verify that delivery orders with fixed-fee markup pricing complied with the maximum contractually established markup rate after modification 16 was signed. DLA Troop Support C&E contract management personnel stated that this occurred because the prime vendor implemented the fixed markup fee pricing strategy differently than intended.

~~(FOUO)~~ In an attempt to clarify the contract provisions related to the fixed fee markup, the contracting officer issued an e-mail dated July 17, 2009, detailing how the MRO PV can implement the contract provisions concerning fixed fee markup pricing. However, as discussed

~~(FOUO)~~ *The prime vendor reached back to cancelled orders and prior contract option years to establish fixed markup fees with effective markups that exceeded the contract's maximum rate.*

previously, the prime vendor reached back to cancelled orders and prior contract options years to establish fixed markup fees with effective markups that exceeded the contract's maximum rate. DLA Troop Support C&E contract management personnel were aware of these concerns, but stated that they had been looking ahead to the issuance of the new 5-year MRO PV contract since September 2011. The new

contract will have a revised acquisition strategy based upon end unit prices that would eliminate the need to evaluate contractor fees. However, DLA Troop Support C&E contract management personnel had to delay award of the new contract and issued its third bridge contract to the current MRO PV contract, extending it until March 2013.

DLA Troop Support C&E contract management personnel provide oversight to MRO prime vendor contractors who initiate delivery orders that are automatically approved, awarded and subject to fast pay procedures. Given this environment, it is critical that DLA Troop Support C&E contract management personnel develop procedures and monitor prime vendor compliance with the contract's maximum markup rate to ensure that questionable costs are promptly identified, investigated, and resolved. DLA Troop Support C&E contract management personnel need to identify, analyze, and determine the allowability of delivery orders that include fixed

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<sup>6</sup> DLA memorandum "Class Deviation from Federal Acquisition Regulation 13.4, Fast Payment Procedure on Individual Orders Up to \$100,000 Issued Against Prime Vendor and Other Long-Term Contracts Requiring Customer Direct Delivery," September 23, 2011, granted DLA the authority to use fast payment procedures for individual orders up to \$100,000 issued against prime vendor and other long-term contracts requiring Customer Direct delivery. The memorandum states that DLA supply chains must continue to ensure the use of systemic practices constituting adequate internal controls for use of fast payment procedures including the required post-payment receipt verifications and inclusion as a special interest item in all Procurement Management Reviews.



markup fees. DLA Troop Support C&E contract management personnel should also conduct a complete review of the purchases made from the date of modification 16, which could result in additional questioned markup fees.

## **Questionable Costs Identified**

The prime vendor charged DoD questioned markup fee and airfreight costs of \$200,224 for purchases the prime vendor made between May 10, 2010, and August 1, 2011. DLA Troop Support is in the process of conducting its own analysis of the questioned markup fee and airfreight costs for the contract. DLA Troop Support may identify additional questioned costs since the inception of the MRO PV contract during their review.

## **Conclusion**

While the prime vendor used price competition to obtain volume discounts and did not take in rebates under the MRO PV contract, DLA Troop Support C&E contract management personnel did not consistently monitor airfreight charges and fixed markup fees the prime vendor charged to DoD for purchases made under the MRO PV contract. This occurred because DLA Troop Support C&E contract management personnel did not have adequate purchase review and approval procedures in place. DLA Troop Support needs to establish procedures that will ensure delivery orders with questionable airfreight and fixed fee markup charges are promptly identified, investigated and resolved. DLA Troop Support also needs to review past transactions to identify and recover confirmed unallowable costs.

## **Recommendations, Management Comments, and Our Response**

**We recommend that the Director, Defense Logistics Agency Troop Support, consistently monitor airfreight charges and fixed markup fees for purchases made under the Maintenance, Repair, and Operations prime vendor contract. Specifically, we recommend that the Director, Defense Logistics Agency Troop Support:**

- 1. Establish procedures to identify, analyze, and determine the allowability of delivery orders that include airfreight and fixed markup fees.**

### ***Management Comments***

The Director, DLA Troop Support, agreed and stated that the Contract Management Plan will be modified to include the procedural changes cited below by September 28, 2012. Specifically, the Director, DLA Troop Support, stated that to ensure high risk orders are reviewed timely, all orders with airfreight charges of \$100 or greater will be reviewed by a contracting officer before award.

Further, the Director, DLA Troop Support, stated that on a quarterly basis, the vendor will submit a report reconciling the difference between the estimated airfreight charges on the original orders and actual airfreight invoice amounts charged by the carrier. The report is due 30 days after the end of the quarter and will be used to recoup overcharges.



Additionally, he indicated the Integrated Supplier Team Chiefs will review the markup fee of all orders awarded the previous quarter and seek reimbursement for overcharges on a quarterly basis. Further, the Director indicated that DLA Troop Support Pacific will obtain documented upfront approval to use airfreight from Korea area ordering activities that request air freight shipments on their requirements and will provide those ordering activities airfreight charge information on a quarterly basis for review.

### ***Our Response***

Comments from the Director, DLA Troop Support were responsive and met the intent of the recommendation. As of the date of this report, DLA Troop Support had not modified the Contract Management Plan, but was circulating a draft version of the modification for management approval. We commend DLA Troop Support for the exceptional response to the recommendation to tighten controls over purchase review and approval procedures. No further comments are required.

## **2. Review the justification for airfreight charges since contract inception, March 2005, and initiate action to recover confirmed unallowable costs.**

### ***Management Comments***

The Director, DLA Troop Support, agreed and stated that DLA will make every reasonable attempt to obtain justifications for airfreight charges since inception of the contract and will recover confirmed unallowable costs. He indicated that the contract requires the supplier to maintain and retain business records, including records relating to shipping, billing, and payments for 3 years from the date of the last invoice. Therefore, the Director stated at a minimum, a review of airfreight charges incurred over the past 3 years will be completed by February 28, 2013.

### ***Our Response***

Comments from the Director, DLA Troop Support were responsive and met intent of the recommendation. No further comments are required.

## **(FOUO) 3. Review fixed markup fees on delivery orders issued on or after May 10, 2010, and initiate action to recover confirmed overcharges where the fixed markup fee exceeded the contractually established maximum of (b) (4) percent.**

### ***Management Comments***

The Director, DLA Troop Support, agreed and stated by December 31, 2012, DLA Troop Support Construction and Equipment Directorate personnel will identify, analyze, and evaluate delivery orders issued after May 10, 2010, where the distribution fee exceeded the contract maximum. Further, the Director stated that Construction and Equipment personnel will initiate action to recover any charges determined by the contracting officer to exceed the contract maximum.

### ***Our Response***

Comments from the Director, DLA Troop Support were responsive and met the intent of the recommendations. No further comments are required.



## **Appendix A. Scope and Methodology**

We conducted this performance audit from August 2011 through July 2012 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. The evidence obtained for this audit provides a reasonable basis for our findings and conclusions based on our audit objectives.

Our objective was to determine whether the prime vendor contractor for South Korea received volume discount savings or rebates and whether the prime vendor credited these savings and rebates to DoD.

We reviewed relevant Federal and DoD contract-related criteria to identify guidance covering volume discounts savings or rebates, management roles and responsibilities of supporting organizations, and reporting requirements.

With assistance from the DoD Office of Inspector General Quantitative Methods Division, we sorted the prime vendor usage data listing for FY 2009 through August 2011, which consisted of 48,925 delivery orders, totaling \$68.5 million. We selected a nonstatistical sample of 72 line items from the universe of 48,925, to determine if the prime vendor obtained volume discounts on DoD purchases. We also selected a nonstatistical sample of 197 line items from 19,017 line items processed after May 10, 2010, when the contract's maximum markup rate was established, through August 1, 2011, to determine why the markup rate exceeded the contract maximum.

To determine whether the prime vendor received volume discounts from purchases it made under the MRO PV contract, we interviewed relevant DLA Troop Support C&E, prime vendor, prime vendor supplier and DFAS personnel. In addition, we reviewed DLA Troop Support C&E, prime vendor, prime vendor suppliers and DFAS policies and procedures concerning volume discounts. In conjunction with Quantitative Methods Division personnel, we sorted the prime vendor usage data by transactions with the greatest potential for volume discounts, including high dollar, frequent and large quantity purchases. We selected a non-statistical sample of 72 line items, totaling approximately \$5.2 million, and reviewed the documentation supporting the contracting officer's fair and reasonable price determination.

We reviewed the supporting documentation to include the DLA contracting officer snapshot portal summary, the original price quotes, supplier invoices, prime vendor payments to the suppliers, and prime vendor charges to DoD for these transactions. Additionally, we independently obtained supporting documentation from the prime vendor, suppliers and DFAS for the delivery orders. In accordance with the FAR adequate competition provisions, we verified that the contracting officer ensured that the prime vendor obtained at least two quotes from its suppliers or adequate justification for each delivery order issued. We also verified that the lowest priced offeror was awarded the delivery order. However, we did not ascertain the market conditions at the time of the award or obtain market prices for items purchased by the prime vendor. We verified the statements made by the DLA Troop Support C&E contract management personnel, prime vendor management officials and suppliers visited that volume discounts are included in the price determination.



~~(FOUO)~~ To determine why the markup rate exceeded the contract's "not to exceed" maximum rate of (b) (4) percent, we selected and reviewed 197 delivery orders. From May 10, 2010, to August 1, 2011, the prime vendor issued 19,017 delivery orders, valued at \$23.1 million, on the MRO PV contract. Because the delivery orders did not always delineate allowable airfreight charges, we compared the product purchase price to the total price charged DoD and identified 6,300 delivery orders (33 percent), valued at \$4.06 million, where the markup rate exceeded the maximum markup rate of (b) (4) percent. These delivery orders appeared to include excessive charges or fees of \$200,224. We concentrated our review on 197 delivery orders, valued at \$1.26 million, where the difference between the product purchase price and the amount charged to DoD exceeded the (b) (4) percent threshold by at least \$100.\* We obtained and reviewed estimated and actual airfreight invoices, purchase orders, and contracting officer records.

In addition, we obtained prime vendor contract information from DLA Troop Support C&E personnel; reviewed the contract and CMP; and discussed the oversight procedures with responsible personnel at DLA Troop Support C&E. We also visited the prime vendor's warehouse in Seattle, Washington; and five of the prime vendor's suppliers to discuss procedures used by the suppliers and the prime vendor to track volume discount savings and rebates to determine whether the prime vendor credited these savings and rebates to DoD.

To determine whether the prime vendor received rebates from purchases it made under the MRO PV contract, we interviewed relevant DLA Troop Support C&E, prime vendor, NORAM, and supplier personnel. In addition, we reviewed prime vendor, NORAM, and supplier policy documents and financial records, including audited, reviewed, and compiled financial statements and related note disclosures for indications of rebate-related activity. In addition, we reviewed rebate-related cash receipts and cash disbursements from October 2008 through August 2011 between NORAM and the prime vendor to identify rebate income generated from MRO PV purchases.

To obtain an understanding of the intent of the volume discount savings and rebates implementation by the prime vendor and its suppliers, including their respective roles and responsibilities, we conducted site visits to the following locations:

- DLA Headquarters in Fort Belvoir, Virginia;
- DLA Troop Support C&E Contracting Office in Philadelphia, Pennsylvania;
- Sodexo Remote Sites in Tacoma, Washington;
- Five prime vendor suppliers located in the Seattle, Washington area;
- Sodexo Remote Sites in Harahan, New Orleans; and
- Sodexo, Inc. (NORAM), Gaithersburg, Maryland.

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\* The \$100 threshold was based on auditor judgment.

## **Use of Computer-Processed Data**

DLA Troop Support C&E contract management personnel provided computer-processed data for purchases that occurred between October 1, 2008 and August 1, 2011, including “Monthly Usage Data” submitted by the prime vendor. We validated certain orders from the Monthly Usage Data with supporting documentation such as quotes and vendor invoices provided by the prime vendor to determine whether Monthly Usage data were accurate; we did not find any errors. We concluded that the data was sufficiently reliable for the purpose of our analysis and findings.

## **Use of Technical Assistance**

The DoD Office of Inspector General, Quantitative Methods Division assisted the audit team in conducting a nonstatistical sample and in determining potential attributes and methods for sampling and analyzing delivery orders placed against the MRO PV contract. Quantitative Methods Division personnel did not use classical statistical sampling techniques that would permit generalizing results to the total population because there were too many potential variables with unknown parameters at the beginning of this analysis. The predictive analytic techniques employed provided a basis for logical coverage of volume discounts and markup rates.

## **Prior Coverage**

During the last 5 years, the Government Accountability Office (GAO) and the Department of Defense Office of Inspector General (DoD IG) issued no final reports discussing volume discounts and rebate savings. However, GAO issued two reports referencing the MRO PV Program. The DoD IG issued two reports specifically discussing the MRO PV contractor for Korea. GAO reports are Internet accessible at <http://www.gao.gov>. Unrestricted DoD IG Reports can be accessed at <http://www.dodig.mil/audit/reports>.

### **GAO**

GAO-07-396R, “Defense Management: DLA Has Made Progress in Improving Prime Vendor Program, but Has Not Yet Completed All Corrective Actions,” February 26, 2007

GAO-06-739R, “Defense Management: Attention Is Needed to Improve Oversight of DLA Prime Vendor Program,” June 19, 2006

### **DoD IG**

D-2011-077, “Improved Management Can Reduce Costs of the Maintenance, Repair, and Operations Prime Vendor Contract for the Republic of Korea,” June 24, 2011

D2010-057, “Public Works Operations at U.S. Army Garrison-Yongsan, Korea,” May 4, 2010



HOUSE OF REPRESENTATIVES  
COMMITTEE ON OVERSIGHT AND GOVERNMENT REFORM

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DECEMBER 28, 2010

The Honorable Gordon S. Heddell  
Inspector General  
Department of Defense  
400 Army Navy Drive  
Arlington, VA 22202

Dear Mr. Heddell:

It has been brought to my attention that a widely used government contractor, Sodexo,  
may be engaged in inappropriate billing practices. I am writing to request that you investigate  
these allegations.

Sodexo is a major contractor for the Department of Defense, holding contracts with the  
Army, Navy, and Marine Corps, as well as the Defense Logistics Agency (DLA). Two of these  
contracts in particular were brought to my attention: the Prime Vendor Contract with DLA to  
supply material and support operations at U.S. military bases in South Korea, and the Regional  
Garlison Food Service Contract with the Marine Corps. It has been alleged that in both of these  
contracts, Sodexo is receiving bulk discounts from its suppliers that it is not passing onto the  
U.S. government. In other words, Sodexo is allegedly fraudulently representing its costs to its  
contracting agencies.

In response to these allegations, my staff met with representatives from DLA and the  
Marine Corps to discuss the contracts with Sodexo. It became clear from the conversation with  
the Marine Corps that the Regional Food Garlison Contract is not structured in such a way that  
would allow for this type of fraudulent billing practice. Under that contract, Sodexo does not  
acquire the food that it serves at Marine bases from its own suppliers; instead, it gets the food  
from DLA. Therefore, Sodexo would not be able to set up the kind of false cost system that has  
been alleged.

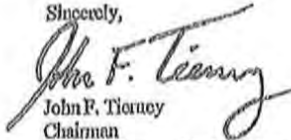
However, our conversations with DLA showed that the Prime Vendor Contract in South  
Korea is potentially susceptible to the alleged fraudulent billing practice. Under this contract,  
suppliers provide invoices to Sodexo, which then provides invoices to DLA. If Sodexo is  
receiving bulk discounts that are not being accurately reflected on its invoices from the suppliers,  
as has been alleged, even a correctly conducted audit would fail to find this particular problem.

Because these allegations involve a major U.S. government contractor, and potentially millions of dollars that are being inappropriately paid by the Department of Defense, I believe it is important to ascertain whether the allegations are accurate. Should you discover that the allegations are, in fact, true, I would urge you to pursue all appropriate legal action against the company. In addition, I would encourage you to do a broader investigation of all Sodexo accounts to uncover the full extent of this problem. Of course, if there is no support for the claims, I am sure that you will make that as broadly known as may be appropriate as well.

You should know, for context at least, that these allegations were raised by the Service Employees International Union (SEIU), which, according to public reports, has been in a dispute with Sodexo over unrelated labor practices. I am enclosing the information that SEIU provided to my office.

Thank you for your attention to this matter.

Sincerely,

  
John F. Tierney  
Chairman  
Subcommittee on National Security  
and Foreign Affairs



## Appendix C. MRO PV Contract Generations and Scope of Review for Questioned Costs

**Table C-1. MRO PV Korea Contract Generations**

|                               | <b>Contract Number</b> | <b>Total Value<sup>1</sup></b><br>(in millions) | <b>Period<sup>1</sup></b>         |
|-------------------------------|------------------------|---|-----------------------------------|
| First generation              | SP0500-99-D-0065       | \$36.4  | September 1, 1999 – June 30, 2005 |
| Second generation             | SPM500-05-D-BP07       | 240.0   | August 1, 2005 – March 31, 2013   |
| Third generation <sup>2</sup> | SPM8E3-11-R-0011       | 230.0   | 5 years from award date           |

<sup>1</sup>Includes all contract options.

<sup>2</sup>Solicitation, not an awarded contract; as of March 22, 2012, DLA suspended the solicitation until further notice.

Source: First and Second generation contract information provided by DLA Troop Support C&E contract management personnel.

Source: Third Generation solicitation information collected from <https://www.fbo.gov>.

**Table C-2. Scope of Review for Questioned Costs,  
Contract SPM500-05-D-BP07 (Partial)**

|   | <b>Delivery Orders</b> | <b>Total Value</b> | <b>Period</b>                    | <b>Questioned Costs</b> |
|---|------------------------|--------------------|----------------------------------|-------------------------|
| Audit Universe  | 48,925                 | \$68,490,327       | October 1, 2008 – August 1, 2011 | TBD <sup>1</sup>        |
| <b>Contract Modification 16 (Mod 16) Went Into Effect May 10, 2010,<br/>Establishing Maximum Markup Rates</b> |                        |                    |                                  |                         |
| Orders placed after Mod 16  | 19,017                 | \$23,154,839       | May 11, 2010 – August 1, 2011    | \$200,224               |
| Questioned costs, any amount  | 6,300                  | 4,065,096          | May 11, 2010 – August 1, 2011    | 200,224                 |
| Questioned costs, \$100 or more   | 197                    | 1,260,043          | May 11, 2010 – August 1, 2011    | 151,821                 |
| Questioned costs attributable to airfreight <sup>2</sup>  | 96                     | 436,111            | May 11, 2010 – August 1, 2011    | 117,004                 |
| Questioned costs attributable to fixed fees   | 97                     | 810,696            | May 11, 2010 – August 1, 2011    | 34,155                  |
| Questioned costs undetermined   | 4                      | 13,235             | May 11, 2010 – August 1, 2011    | 662                     |

<sup>1</sup>We did not review orders placed before Mod 16 went into effect; we recommended that DLA review airfreight charges on orders placed before Mod 16 and request reimbursement for unallowable costs. See Recommendation 2 on page 13.

<sup>2</sup>Fixed fees also contributed to the effective markup rate in 14 of 96 airfreight orders.

Source: DoD Office of Inspector General.

## Defense Logistics Agency Comments



DEFENSE LOGISTICS AGENCY  
TROOP SUPPORT  
700 ROBBINS AVENUE  
PHILADELPHIA, PENNSYLVANIA 19111-5092

SEP 11 2012

MEMORANDUM FOR INSPECTOR GENERAL, DEPARTMENT OF DEFENSE

THROUGH: DIRECTOR, DEFENSE LOGISTICS AGENCY (DLA) ACQUISITION

SUBJECT: DoD IG Project No. D2011-D000LD-0261.000, "Volume Discount and Rebate Billing Practices for the Maintenance, Repair, and Operations Prime Vendor Contractor for U.S. Installations in South Korea"

This responds to your memorandum dated August 2, 2012, requesting comments from the Director, DLA, on the recommendations in the subject report. We appreciate the opportunity to review and offer comments to the draft report and would like to thank the audit team for the professionalism and attention to detail during the performance of the audit. DLA Troop Support concurs with the finding and recommendations in the draft report with clarifying comments. We anticipate fully implementing the actions cited under each recommendation no later than February 28, 2013.

The following responses are provided to address the recommendations:

**DoD IG Finding:** DLA Troop Support Construction and Equipment (C&E) purchase review process needs improvement.

**Recommendation 1:** We recommend that the Director, DLA Troop Support, establish procedures to identify, analyze, and determine the allowability of delivery orders that include airfreight and fixed markup fees.

**DLA Response:** Concur.

- The Contract Management Plan will be modified to include the procedural changes cited below by September 28, 2012.
- All orders that include airfreight will be coded as airfreight orders by the vendor on their 855 EDI transactions when submitting them into the Contracting Officers Portal (KOP). The KOP controls the establishment of all prime vendor orders awarded in the Enterprise Business System. All orders that have an airfreight charge \$100 or greater will be reviewed by a Contracting Officer on a pre-award basis ensuring that high risk orders are reviewed prior to award. On a quarterly basis, the vendor will submit a report of the airfreight orders for the previous quarter that will include the amount of airfreight estimated on the original orders and the actual invoice amounts charged by the carrier. This report will be due 30 days after the end of the quarter. The purpose is to reconcile the difference between the estimated and actual airfreight charges and recoup overcharges to the Government. Negotiations are in process with the vendor in order to establish



reimbursement procedures and reporting requirements that will be executed by a two-party modification and is expected to be issued by September 27, 2012. Discussions are being conducted with the C&E J-8 Comptroller to assist in the process of recouping any overcharges that are identified and reimburse the vendor when undercharged.

- On a quarterly basis, the Integrated Supplier Teams (IST) Chief will review the markup fee of all orders awarded during the previous quarter. The IST Chief will seek reimbursement for any dollar amount determined to exceed the contract's maximum distribution fee.
- The DLA Troop Support Pacific office will issue a letter by September 14, 2012, to the Korea area ordering activities who request airfreight shipment on their requirements. The purpose of the letter is to obtain their upfront approval to use airfreight when submitting their orders. The ordering activity will sign the letter and it will be placed in the contract file. On a quarterly basis, ordering activities will receive airfreight charge information for their review.

**Recommendation 2:** We recommend that the Director, DLA Troop Support, review the justification for airfreight charges since contract inception, March 2005, and initiate action to recover confirmed unallowable costs.

**DLA Response:** Concur.

- DLA agrees to make every reasonable attempt to obtain justifications for airfreight charges since inception of the contract to recover confirmed unallowable costs. Per contract provision titled "Record-Audit Rights", which states the supplier agrees to maintain business records, books and account information relating to the products purchased by DLA Troop Support under this contract, including records relating to shipping, billing, payments, and to retain the same for at least three (3) years from the date of the last invoice. However, it is possible that the contractor does not have records prior to the 3 year requirement. At a minimum, a review of airfreight charges incurred over the past three years will be completed by February 28, 2013.

**Recommendation 3:** We recommend that the Director, DLA Troop Support, review fixed markup fees on delivery orders issued on or after May 10, 2010 and initiate action to recover confirmed overcharges where the fixed markup fee exceeded the contractually established maximum of (b) (4) percent.

**DLA Response:** Concur.

- By December 31, 2012, DLA Troop Support C&E will identify, analyze and evaluate delivery orders issued after May 10, 2010, where the distribution fee

exceeded the contract maximum of (b) (4) established by modification P00016, issued May 10, 2010. When applicable, C&E will initiate action to recover any charges determined by the Contracting Officer to exceed the contract maximum.

*for Edward D. Case*  
MARK D. HARNITCHIEK  
Vice Admiral, USN  
Director



**FOR OFFICIAL USE ONLY**

Report No. DODIG-2013-006

October 19, 2012



# Inspector General Department of Defense

Defense Logistics Agency Could Improve Its  
Oversight of the Maintenance, Repair, and  
Operations Prime Vendor Contract for Korea

**FOR OFFICIAL USE ONLY**